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C O N F I D E N T I A L SECTION 01 OF 02 RIGA 000081

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TREASURY FOR DAVID WRIGHT

E.O. 12958: DECL: 02/08/2019
TAGS: PGOV ECON EFIN LG
SUBJECT: DECISION ON PAREX BANK'S SYNDICATED LOANS DUE THIS WEEK

Classified By: Charge d' Affaires a.i. Bruce Rogers for Reason 1.4 (d)

¶1. (C) Summary. Parex Bank Chairman Nils Melngailis told Charge that Parex has no available cash to put towards repayment of its two large syndicated loans at this time. The lenders, he said, have rejected any debt for equity swap arrangements, so payment on the debt falls to the Latvian government and is limited by government revenue flows. Even with receipt of the first tranches of IMF, EC, and Swedish financial assistance, government revenue flows will not allow for full repayment under the current terms, so Parex will meet in London on February 10-11 with the lenders to gain agreement to a restructured payment schedule. If no agreement can be reached, contingency planning has started on splitting Parex into two banks - a "good bank-bad bank" arrangement. Melngailis did not rule out a possible last-minute, "white-knight" investor coming into the picture, but also left open the possibility that some power centers in Latvia would like to see talks fail in order to pick up Parex assets at fire-sale prices. End summary.

¶2. (C) Parex Bank has outstanding syndicated loan debts of 775 million euros (roughly $1 billion USD) that come due in ¶2009. The first repayment of 275 million euros is due on February 19, and the remainder in June. Parex has been in negotiations with the syndicate lenders, a group of 60 banks, according to Melngailis, since late 2008 when fleeing investors forced the government of Latvia to purchase an 85% share in the bank to restore confidence in the institution. Melngailis said that deposit flight had stopped, and they have even seen money coming back into the bank in recent days. However, the bank currently has no funds available for debt servicing and repayment of the syndicated loans will fall to the government. He noted that even with recent agreements for international financial assistance, the government's falling revenue flows won't allow full repayment under the debt's current terms. Based on the government's limitations, Parex has proposed a revised schedule that would pay 20% of the total debt (155 million euros, $200 million USD) on February 19, another 50% in February 2010, and the remaining 30% of the debt by January 2012. Interest would be revised to current market rates, with all payments guaranteed by the GOL.

¶3. (C) Melngailis said that discussions with lenders have been tough, and that all 60 banks would technically have to accept the rescheduling plan, though in practice, a majority group could buy out a few dissenters to reach agreement. He said that Parex has already started contingency planning on options should debt rescheduling fail. He said one option would be to split the bank following a "good bank-bad bank" model, with troubled assets falling to the bad bank. In the mean time, he added, it is possible that an outside investor would emerge that could buy the bank for essentially the cost of taking over the debt, which including additional subordinated debt owed by Parex, would total about $2.5 billion USD.

¶4. (C) Melngailis thought that finding an investor interested in Parex is possible, even in these times. He said that one benefit of the past bank ownership's management was that Parex has always had a very strong legal department which has locked down assets and collateral, so the bank's underlying asset structure is more secure than other Latvian banks. In addition, he discussed, ongoing due diligence audits following the government takeover have so far not turned up anything damaging or unusual in the banks structure or balance sheets, as some had speculated may exist. He mentioned that Parex has been working with the American investment firm Blackstone as a consultant, though Blackstone itself if not interested in purchasing Parex.

¶5. (C) Concluding the meeting, he observed that there are some in Latvia who may wish to keep Parex in a precarious state, hoping to eventually pick up its assets in a collapse scenario at "fire-sale" prices. He noted that Ventspils mayor, and reputed oligarch, Aivars Lembergs has seemed particularly vocal in the press attacking Melngailis and the government's actions with Parex. The bank has also seen ex-Parex officials now employed with Latvian Aizkraukles Bank using confidential customer data to email key Parex clients in an attempt to have them switch banking institutions. He said Parex has taken action against Aizkraukles Bank both through the Latvian banking regulator (FCMC) and with the police. Though he thought Swedish banks operating in Latvia have been aggressively marketing to attract Parex depositors, he did not think such competition was outside of normal commercial bounds.

¶6. (C) Comment: Melngailis painted a scenario of a bank that has stopped hemorrhaging deposits, but that is still in a weakened state and totally dependent on the Latvian government for support with debt payments. This week should provide the answer of whether the bank has a shot at a gradual recovery or if extreme scenarios play out. The government has not done well with past big-money decisions, as Melngailis pointed out that if Latvia had completed its privatization of Lattelekom (which Melgailis chaired) last year, government coffers would have about a billion dollars more to deal with current problems. Parex's lenders will now decide if the amount Latvia can currently repay and government guarantees of future repayment are enough to delay the bank's day of reckoning. If this "best offer" is rejected, ripples of a Parex collapse could take a huge toll on investor confidence in Latvia.
ROGERS